

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

TABLE OF CONTENTS

| | <u>Page</u> |
|---|--------------------|
| INDEPENDENT AUDITORS' REPORT | 1 - 3 |
| MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited) | 4 - 9 |
| BASIC FINANCIAL STATEMENTS | |
| Proprietary Fund | |
| Statements of Net Position | 10 - 11 |
| Statements of Revenues, Expenses, and Changes in Net Position | 12 |
| Statements of Cash Flows | 13- 14 |
| Fiduciary Fund | |
| Statements of Net Position | 15 |
| Statements of Changes in Net Position | 16 |
| Notes to Financial Statements | 17 - 40 |
| REQUIRED SUPPLEMENTARY INFORMATION (Unaudited) | |
| Schedule of Funding Progress | 41 |
| Schedule of Proportionate Share of Net Pension Liability | 42 |
| Schedule of Contributions | 43 |
| OTHER INFORMATION (Unaudited) | |
| Schedule of Operating Expenses | 44 |

INDEPENDENT AUDITORS' REPORT

To the Municipal Light Board
South Hadley Electric Light Department
South Hadley, Massachusetts

Report on the Financial Statements

We have audited the accompanying financial statements of the South Hadley Electric Light Department and OPEB Liability Trust, proprietary and fiduciary funds, respectively, of the Town of South Hadley, Massachusetts, as of and for the year ended December 31, 2016, and the related notes to the financial statements, as listed in the table of contents. Hereafter the funds will collectively be referred to as "South Hadley Electric Light Department."

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to South Hadley Electric Light Department's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of South Hadley Electric Light Department's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To the Municipal Light Board
South Hadley Electric Light Department

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the proprietary and fiduciary funds of the South Hadley Electric Light Department as of December 31, 2016, and the changes in its financial position and its cash flows, where applicable, for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the proprietary and fiduciary funds of the South Hadley Electric Light Department, as of and for the year ended December 31, 2015, were audited by other auditors whose report dated July 21, 2016, expressed an unmodified opinion on those statements. The other auditors included an emphasis of a matter related to uncertainty surrounding the accrued sick and vacation time payable to a former employee.

Emphasis of Matters

As discussed in Note 1, the financial statements present only the South Hadley Electric Light Department proprietary and fiduciary funds and do not purport to, and do not present fairly the financial position of the Town of South Hadley, Massachusetts, as of December 31, 2016 and 2015 and the changes in its financial position and its cash flows, where applicable, for the years then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

As discussed in Note 4 to the financial statements, the Department is not in compliance with certain provisions of GASB Statement No. 68 related to pension as of December 31, 2016 due to the timing of actuary reports completed for the Hampshire County Retirement System. Our opinions are not modified with respect to this matter.

As discussed in Note 8 to the financial statements, net position as of January 1, 2015 and December 31, 2015 have been restated to correct an error in the calculation of accrued compensated absences. Our opinions are not modified with respect to this matter.

Other Matters

Restatement of Prior Year Financial Statements Audited by Predecessor Auditor

As part of our audit of the 2016 financial statements, we also audited the adjustments described in Note 8 that were applied to restate the 2015 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2015 financial statements of the proprietary and fiduciary funds of the South Hadley Electric Light Department other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2015 financial statements as a whole.

To the Municipal Light Board
South Hadley Electric Light Department

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the required supplementary information as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us sufficient evidence to express an opinion or provide an assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements as a whole. The schedule of operating expenses as listed in the table of contents, which is the responsibility of management, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion or provide any assurance on it.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
November 16, 2017

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

MANAGEMENT DISCUSSION AND ANALYSIS

AS OF AND FOR THE YEARS ENDING DECEMBER 31, 2016 AND 2015

Within this section of the South Hadley Electric Light Department's ("the Department") annual financial report, management provides a narrative discussion and analysis of the Department's financial activities as of and for the years ending December 31, 2016 and 2015. The Department's performance is discussed and analyzed within the context of the accompanying financial statements and disclosures.

Overview of the Financial Statements

The Department is a self-supporting enterprise fund of the Town of South Hadley, Massachusetts that operates a retail electric power distribution system subject to regulation by the Federal Energy Regulatory Commission ("FERC") and the Massachusetts Department of Public Utilities ("DPU"). The Department's financial statements are presented in accordance with Accounting Principles Generally Accepted in the United States of America ("GAAP") using the economic resource measurement focus and the accrual basis of accounting. The Department operates and maintains its own sub-station, 92+ miles of overhead lines, 55+ miles of underground lines, 925+ transformers, 1,875+ street lights, and services approximately 8,000 residential, commercial, industrial, and municipal customers.

The Statement of Net Position includes all of the Department's assets, deferred outflows, and liabilities at a certain point in time. It provides information about the nature and magnitude of the Department's investments in resources and its obligations to creditors. This statement provides a basis for evaluating the capital structure and liquidity of the utility.

The following is a summary of the Department's net position at December 31, 2016 and 2015.

| CONDENSED COMBINED STATEMENT OF NET POSITION | | |
|---|----------------------|--------------------------|
| | 2016 | Restated 2015 |
| ASSETS | | |
| Current | \$ 16,115,238 | \$ 15,974,826 |
| Restricted | 7,858,759 | 7,008,637 |
| Non-current | 489,286 | |
| Capital - Net | 4,766,089 | 5,791,009 |
| Deferred Outflows | 1,258,126 | 531,537 |
| TOTAL ASSETS AND DEFERRED OUTLOWS | \$ 30,487,498 | \$ 29,306,009 |
| LIABILITIES AND NET POSITION | | |
| Current | \$ 1,586,477 | \$ 999,917 |
| Long-Term | 5,035,982 | 3,644,759 |
| Net Position | | |
| Net Investment in Capital Assets | 4,766,089 | 5,791,009 |
| Restricted | 6,863,597 | 6,172,887 |
| Unrestricted | 12,235,353 | 12,697,437 |
| TOTAL LIABILITIES AND NET POSITION | \$ 30,487,498 | \$ 29,306,009 |

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

MANAGEMENT DISCUSSION AND ANALYSIS

AS OF AND FOR THE YEARS ENDING DECEMBER 31, 2016 AND 2015

The Statement of Revenues, Expenses and Changes in Net Position includes all of the Department's revenues, expenses, capital contributions, and operating transfers for a discrete period in time. It provides information about the sources and magnitude of the Department's income and nature and magnitude of its expenses. This statement provides a basis for evaluating the financial performance of the utility.

The following is a summary of the Department revenues, expenses and changes in net position for the years ended December 31, 2016 and 2015.

| CONDENSED COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION | | |
|---|---------------------|--------------------------|
| | 2016 | Restated 2015 |
| OPERATING REVENUES | \$ 14,501,235 | \$ 15,364,724 |
| OPERATING EXPENSES | | |
| Cost of Power Sold | 10,623,161 | 11,522,547 |
| Distribution Expense | 988,177 | 946,461 |
| Customer Accounts Expense | 310,778 | 362,326 |
| General and Administrative Expense | 2,146,579 | 1,344,796 |
| Depreciation Expense | 1,042,712 | 1,071,808 |
| TOTAL OPERATING EXPENSES | 15,111,407 | 15,247,938 |
| OPERATING INCOME (LOSS) | (610,172) | 116,786 |
| NONOPERATING REVENUES (EXPENSES) | (10,548) | 45,209 |
| OTHER FINANCING SOURCES (USES) | (175,574) | (112,378) |
| CHANGE IN NET POSITION | \$ (796,294) | \$ 49,617 |

The Statement of Cash Flows includes all of the Department's cash receipts and cash expenditures for a discrete period in time. It provides information about the nature and magnitude of the Department's cash flows provided by and used in operating activities, financing activities, and investing activities. This statement also provides a basis for evaluating the financial performance of the utility as well as providing additional information necessary to explain the changes in the Department's net position.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

MANAGEMENT DISCUSSION AND ANALYSIS

AS OF AND FOR THE YEARS ENDING DECEMBER 31, 2016 AND 2015

The following is a summary of the Department's sources and uses of cash for the years ended December 31, 2016 and 2015.

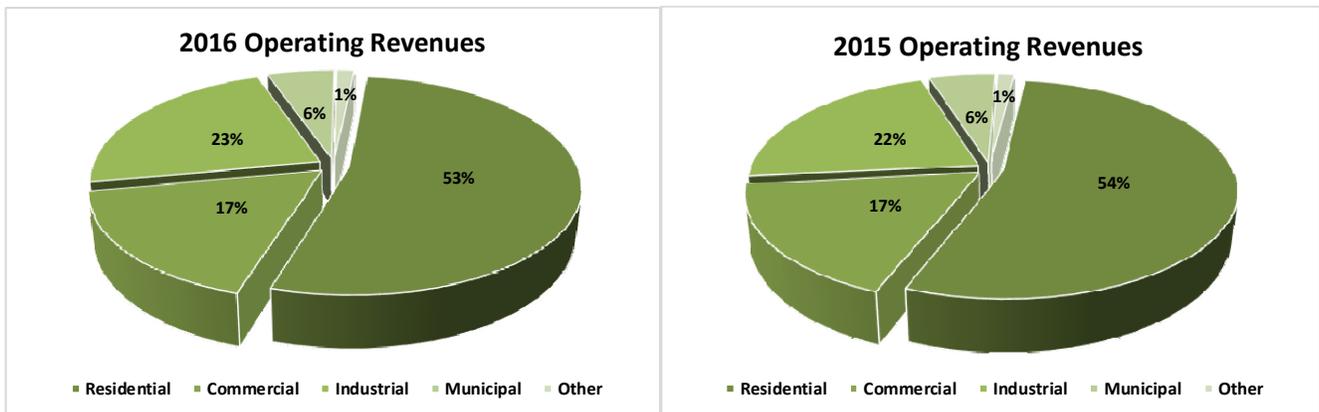
| CONDENSED COMBINED STATEMENT OF CASH FLOWS | | |
|---|---------------------|--------------------------|
| | 2016 | Restated 2015 |
| CASH FLOW PROVIDED BY (USED IN): | | |
| Operating Activities | \$ 1,598,112 | \$ 1,626,147 |
| Financing Activities | (835,816) | (1,084,523) |
| Investing Activities | 39,331 | 29,846 |
| NET INCREASE (DECREASE) IN CASH | 801,627 | 571,470 |
| CASH - BEGINNING | 8,636,175 | 8,064,705 |
| CASH - ENDING | \$ 9,437,802 | \$ 8,636,175 |

Financial Highlights and Analysis

Sales of electricity for 2016 of \$14,354,505 decreased by \$849,454, or 5.59% from the prior year. kWh sales for 2016 of 112,386,311 increased by 496,345, or 0.44% from the prior year. The decrease in revenues was primarily due to a reduction in power costs passed on to our customers.

Other operating revenues for 2016 of \$146,730, which consists of equipment rentals, pole attachment fees, and fiber income decreased by \$14,035 from the prior year.

The following provides a comparative distribution of operating revenues for the years ended December 31, 2016 and 2015.



SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

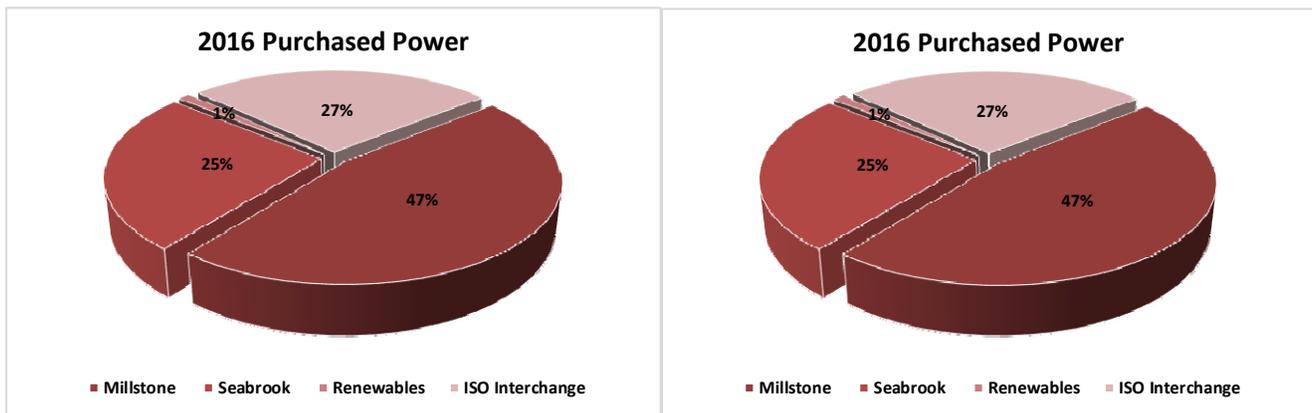
MANAGEMENT DISCUSSION AND ANALYSIS

AS OF AND FOR THE YEARS ENDING DECEMBER 31, 2016 AND 2015

The Department secures power for its customers through both purchased power agreements and open market acquisitions in an effort to stabilize power costs. The cost of power sold includes the costs associated with buying capacity, energy, and transmission.

The cost of power sold for 2016 of \$10,623,161, decreased by \$899,386, or 7.81% from the prior year. kWh purchases for 2016 of 116,925,301 increased by 291,974, or 0.25% from the prior year. The decrease in costs were primarily due to debt service cost reductions in our purchased power agreements and changes in the wholesale market price of electricity.

The following provides a comparative distribution of the purchased power for the years ended December 31, 2016 and 2015.



Other operating expenses for 2016, excluding depreciation, of \$3,445,534 increased by \$791,951, or 29.84% from the prior year.

Nonoperating revenues (expenses) and other financing sources (uses), which consists of interest and investment earnings, other nonoperating expenses, gains or losses on capital assets dispositions, capital contributions and transfers to the Town, decreased by \$118,953 from the prior year.

Current assets, which consist of cash, the MLDM Reserve Trust, accounts receivable, inventory, and prepaid and other assets, increased by \$140,412 from the prior year.

Current liabilities, which consist of accounts payables, current portion of accrued compensated absences, customer deposits, and accrued liabilities, increased by \$586,560 from the prior year. The increase was primarily due to changes in accounts payable, accrued liabilities and customer deposits.

Restricted assets, which consist of customer deposits, the depreciation fund, the OPEB Liability Trust, and purchased power advances, increased by \$850,122 from the prior year. The increase was primarily due to changes in the depreciation fund.

Non-current assets, which consist of preliminary survey and investigation charges, increased by \$489,286 as a result of the transfer of new facility design costs from construction-in-progress.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

MANAGEMENT DISCUSSION AND ANALYSIS

AS OF AND FOR THE YEARS ENDING DECEMBER 31, 2016 AND 2015

Deferred outflows, which consist of pension related costs applicable to future reporting periods, increased by \$726,589 over the prior year.

Long-term liabilities, which consist of the net pension liability, accrued compensated absences, other noncurrent liabilities, and other post employment benefits increased by \$1,391,223 from the prior year. The increase was primarily due to changes in net pension liability and other noncurrent liabilities.

With the exception of the required payments under purchased power agreements, the Department has no long-term debt service.

Net capital assets decreased by \$1,024,920 from 2015 due to capital improvements made which were less than the current provision for depreciation and due to abandoned and reclassified construction-in-progress costs.

The following is a summary of the Department's capital assets at December 31, 2016 and 2015.

| SUMMARY OF CAPITAL ASSETS | | |
|---------------------------------|---------------------|---------------------|
| | 2016 | 2015 |
| CAPITAL ASSETS | | |
| Distribution Plant | \$ 29,578,009 | \$ 29,331,508 |
| General Plant | 5,485,018 | 5,425,563 |
| Land | 344,448 | 344,448 |
| Construction-in-progress | 54,720 | 630,573 |
| TOTAL | 35,462,195 | 35,732,092 |
| ACCUMULATED DEPRECIATION | 30,696,106 | 29,941,083 |
| CAPITAL ASSETS - NET | \$ 4,766,089 | \$ 5,791,009 |

The Department realized an overall decrease in net position for 2016 of \$796,294 and an increase in net position for 2015 of \$49,617. Cash flows from operating activity activities for both years were more than sufficient to cover operating expenses.

Additional information on all of the matters included in this report can be found in the accompanying financial statement and notes.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

MANAGEMENT DISCUSSION AND ANALYSIS

AS OF AND FOR THE YEARS ENDING DECEMBER 31, 2016 AND 2015

Requests for Information

This financial report is designed to provide a general overview of the South Hadley Electric Light Department's finances for all those with an interest in the utility's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

Financial Manager

South Hadley Electric Light Department

85 Main Street

South Hadley, Massachusetts 01075

**SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
 PROPRIETARY FUND
 STATEMENT OF NET POSITION
 DECEMBER 31, 2016 AND 2015**

ASSETS AND DEFERRED OUTFLOWS

| | 2016 | Restated 2015 |
|---|----------------------|--------------------------|
| CURRENT ASSETS | | |
| Cash - operation fund | \$ 3,366,505 | \$ 3,331,598 |
| MLDM Reserve Trust | 11,835,932 | 11,783,050 |
| Accounts receivable - net of allowance for uncollectible accounts of \$354,851 in 2016 and \$350,000 in 2015 | 447,340 | 350,888 |
| Inventory | 420,122 | 461,978 |
| Prepaid expenses and other assets | 45,339 | 47,312 |
| Total Current Assets | 16,115,238 | 15,974,826 |
| RESTRICTED ASSETS | | |
| Cash - depreciation fund | 5,724,967 | 5,048,467 |
| Cash - customer deposits | 346,330 | 256,110 |
| Purchased power advances | 1,121,251 | 1,088,252 |
| Total Restricted Assets | 7,192,548 | 6,392,829 |
| NONCURRENT ASSETS | | |
| Preliminary survey and investigation charges | 489,286 | - |
| Total Noncurrent Assets | 489,286 | - |
| CAPITAL ASSETS | | |
| Distribution plant | 29,578,009 | 29,331,508 |
| General plant | 5,485,018 | 5,425,563 |
| Land | 344,448 | 344,448 |
| Construction-in-progress | 54,720 | 630,573 |
| Total | 35,462,195 | 35,732,092 |
| Less: Accumulated depreciation | 30,696,106 | 29,941,083 |
| Capital Assets - Net | 4,766,089 | 5,791,009 |
| DEFERRED OUTFLOWS | | |
| Pension related deferrals | 1,258,126 | 531,537 |
| Total Deferred Outflows | 1,258,126 | 531,537 |
| TOTAL ASSETS AND DEFERRED OUTFLOWS | \$ 29,821,287 | \$ 28,690,201 |

The accompanying notes are an integral part of these financial statements.

**SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
 PROPRIETARY FUND
 STATEMENT OF NET POSITION
 DECEMBER 31, 2016 AND 2015**

LIABILITIES AND NET POSITION

| | 2016 | Restated 2015 |
|---|----------------------|--------------------------|
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 668,370 | \$ 534,222 |
| Current portion of accrued compensated absences | 154,114 | 170,393 |
| Customer deposits | 346,330 | 256,110 |
| Accrued liabilities | 417,663 | 39,192 |
| Total Current Liabilities | 1,586,477 | 999,917 |
| LONG-TERM LIABILITIES | | |
| Net pension liability | 3,761,021 | 2,976,687 |
| Accrued compensated absences (as restated) | 26,129 | 88,432 |
| Other noncurrent liabilities | 600,000 | - |
| Other post-employment benefits | 648,832 | 579,640 |
| Total Long-Term Liabilities | 5,035,982 | 3,644,759 |
| TOTAL LIABILITIES | 6,622,459 | 4,644,676 |
| NET POSITION | | |
| Net investment in capital assets | 4,766,089 | 5,791,009 |
| Restricted | 6,846,218 | 6,136,719 |
| Unrestricted (as restated) | 11,586,521 | 12,117,797 |
| Total Net Position | 23,198,828 | 24,045,525 |
| TOTAL LIABILITIES AND NET POSITION | \$ 29,821,287 | \$ 28,690,201 |

The accompanying notes are an integral part of these financial statements.

**SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
 PROPRIETARY FUND
 STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
 YEARS ENDED DECEMBER 31, 2016 AND 2015**

| | 2016 | Restated 2015 |
|---|---------------|--------------------------|
| OPERATING REVENUES | | |
| Residential | \$ 7,703,532 | \$ 8,295,992 |
| Commercial | 2,487,260 | 2,680,849 |
| Industrial | 3,287,731 | 3,334,748 |
| Municipal | 810,524 | 846,316 |
| Other | 212,188 | 206,819 |
| Total Operating Revenues | 14,501,235 | 15,364,724 |
| OPERATING EXPENSES | | |
| Cost of power sold | 10,623,161 | 11,522,547 |
| Distribution expense | 988,177 | 946,461 |
| Customer accounts expense | 310,778 | 362,326 |
| General and administrative expense (as restated) | 2,146,579 | 1,344,796 |
| Depreciation expense | 1,042,712 | 1,071,808 |
| Total Operating Expenses | 15,111,407 | 15,247,938 |
| OPERATING INCOME (LOSS) | (610,172) | 116,786 |
| NONOPERATING REVENUES (EXPENSES) | | |
| Interest and investment income | 92,213 | 125,721 |
| Gain (loss) on disposition of capital assets | 81,836 | (73,425) |
| Other nonoperating expense | (235,000) | - |
| Net nonoperating revenues (expenses) | (60,951) | 52,296 |
| INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS OUT | (671,123) | 169,082 |
| CAPITAL CONTRIBUTIONS | 37,696 | 115,374 |
| TRANSFERS TO TOWN | (213,270) | (227,752) |
| CHANGE IN NET POSITION | (846,697) | 56,704 |
| NET POSITION - BEGINNING (as restated) | 24,045,525 | 23,988,821 |
| NET POSITION - ENDING | \$ 23,198,828 | \$ 24,045,525 |

The accompanying notes are an integral part of these financial statements.

**SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
 PROPRIETARY FUND
 STATEMENTS OF CASH FLOWS
 YEARS ENDED DECEMBER 31, 2016 AND 2015**

| | <u>2016</u> | <u>Restated 2015</u> |
|---|---------------------|--------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Receipts from customers | \$ 14,404,783 | \$ 15,846,315 |
| Payments to power suppliers | (10,510,253) | (11,553,640) |
| Payments to employees | (1,279,822) | (1,365,610) |
| Payments for other operations | (1,016,596) | (1,300,918) |
| Net cash provided by operating activities | <u>1,598,112</u> | <u>1,626,147</u> |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES | | |
| Transfer to Town | (213,270) | (227,752) |
| Other nonoperating expense | (235,000) | - |
| Net cash used in noncapital financing activities | <u>(448,270)</u> | <u>(227,752)</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Acquisition of capital assets | (507,078) | (1,032,175) |
| Capital contributions | 37,696 | 115,374 |
| Proceeds from disposition of capital assets | 81,836 | 60,030 |
| Net cash used in capital and related financing activities | <u>(387,546)</u> | <u>(856,771)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Interest and investment income | 92,213 | 125,721 |
| (Increase) decrease in investment - MLDM Reserve Trust | (52,882) | (95,875) |
| Net cash provided by investing activities | <u>39,331</u> | <u>29,846</u> |
| NET INCREASE IN CASH | 801,627 | 571,470 |
| CASH - BEGINNING OF YEAR | <u>8,636,175</u> | <u>8,064,705</u> |
| CASH - END OF YEAR | <u>\$ 9,437,802</u> | <u>\$ 8,636,175</u> |

The accompanying notes are an integral part of these financial statements.

**SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
 PROPRIETARY FUND
 STATEMENTS OF CASH FLOWS
 YEARS ENDED DECEMBER 31, 2016 AND 2015**

| | 2016 | Restated 2015 |
|---|---------------------|--------------------------|
| RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES | | |
| Operating income (loss) | \$ (610,172) | \$ 116,786 |
| Adjustments to reconcile operating income (loss) to net cash provided by operating activities: | | |
| Depreciation | 1,042,712 | 1,071,808 |
| Changes in assets and liabilities: | | |
| Purchased power advances | (32,999) | (7,637) |
| Accounts receivable | (96,452) | 481,591 |
| Inventory | 41,856 | (23,002) |
| Prepaid expenses and other assets | 1,973 | 3,279 |
| Pension related deferrals | (726,589) | (120,920) |
| Accounts payable | 134,148 | (137,952) |
| Customer deposits | 90,220 | 76,260 |
| Accrued liabilities | 373,607 | 14,455 |
| Net pension liability | 784,334 | 112,454 |
| Accrued compensated absences | (73,718) | 22,391 |
| Other noncurrent liabilities | 600,000 | - |
| Other post-employment benefits | 69,192 | 16,634 |
| Net cash provided by operating activities | \$ 1,598,112 | \$ 1,626,147 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

The following accounts are considered to be cash for the statement of cash flows:

| | | |
|---------------------------|---------------------|---------------------|
| Cash - depreciation fund | \$ 5,724,967 | \$ 5,048,467 |
| Cash - customer deposits | 346,330 | 256,110 |
| Cash - operation fund | 3,366,505 | 3,331,598 |
| CASH - END OF YEAR | \$ 9,437,802 | \$ 8,636,175 |

The accompanying notes are an integral part of these financial statements.

**SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
 FIDUCIARY FUND
 STATEMENTS OF NET POSITION
 DECEMBER 31, 2016 AND 2015**

| | <u>2016</u> | <u>2015</u> |
|---------------------------|-------------------|-------------------|
| ASSETS | | |
| ASSETS | | |
| OPEB Liability Trust | \$ 666,211 | \$ 615,808 |
| TOTAL ASSETS | <u>\$ 666,211</u> | <u>\$ 615,808</u> |
| NET POSITION | | |
| NET POSITION | | |
| Held in Trust | \$ 666,211 | \$ 615,808 |
| TOTAL NET POSITION | <u>\$ 666,211</u> | <u>\$ 615,808</u> |

The accompanying notes are an integral part of these financial statements.

**SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
 FIDUCIARY FUND
 STATEMENTS OF CHANGES IN NET POSITION
 YEARS ENDED DECEMBER 31, 2016 AND 2015**

| | 2016 | 2015 |
|---------------------------------------|-------------|-------------|
| ADDITIONS | | |
| Interest and investment income | \$ 50,403 | \$ (7,087) |
| CHANGE IN NET POSITION | 50,403 | (7,087) |
| TOTAL NET POSITION - BEGINNING | 615,808 | 622,895 |
| TOTAL NET POSITION - ENDING | \$ 666,211 | \$ 615,808 |

The accompanying notes are an integral part of these financial statements.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The South Hadley Electric Light Department (the "Department") is a proprietary fund of the Town of South Hadley, Massachusetts (the "Town"). The Department provides electric service to residential, commercial, industrial, and municipal customers, substantially all of whom are located within the Town.

Measurement Focus and Basis of Accounting

The Department's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. The Department's accounting records are maintained in accordance with accounting principles generally accepted in the United States of America ("GAAP") for proprietary and fiduciary funds as promulgated by the Governmental Accounting Standards Board ("GASB") and generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the United States Federal Energy Regulatory Commission ("FERC").

Public Utility Regulation

Arrangements among the Department, outside agencies, and other utilities covering interconnections, interchange of electric power, and sales of utility property are subject to regulation by the FERC. The Department is subject to further regulation by the Massachusetts Department of Public Utilities ("DPU"). Under Massachusetts law, electric rates are set by the Municipal Light Board. While the DPU exercises general supervisory authority over the Department, rates are not subject to DPU approval.

Cash and Investments

Cash includes cash on hand, on deposit with the Town, which is in the custody of and managed by the Town Treasurer, and held by Massachusetts Municipal Wholesale Electric Company ("MMWEC"). The Department considers all short-term investments with an original maturity date of 90 days or less to be cash.

Investments are stated at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties. Fair values are based on quoted market prices. Dividend and interest income is recorded when declared.

Massachusetts General Laws place limitations on the nature of deposits and investments available to the Department. Cash and investment, which are subject to legislation, regulation, or agreement that limit the use of such funds, are reflected as restricted assets.

Cash, for purposes of the cash flow statement, consists of cash on hand and on deposit with the Town.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Municipal Light Departments of Massachusetts Reserve Trust

The Municipal Light Department of Massachusetts Reserve Trust ("MLDM Reserve Trust") was established by Massachusetts Municipal Wholesale Electric Company ("MMWEC") in anticipation of deregulation of the electric industry in Massachusetts. The Trust was established to help maintain the competitive position of its member utilities, in the face of increasing competition from investor owned utilities, by providing a source of funds to be accessed as needed for extraordinary or unanticipated expenses such as unit outages, loss of load, and retail wheeling.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect. Management provides for uncollectable amounts through a charge against income based on its assessment of the current status of individual accounts. Management is required to comply with the billing and termination procedures mandated by the DPU. No interest is charged on residential accounts. The Department obtains security interests as it deems appropriate.

Inventory

Inventory, which consists of poles and fixtures, conductors and devices, underground conduits, transformers, meters and street lights, is valued at the lower of cost or market using the first-in, first-out flow assumption.

Other Post-Employment Benefit Liability Trust

The Other Post-Employment Benefit Liability Trust ("OPEB Liability Trust") was established by the Department pursuant to Chapter 32B, Section 20 of the General Laws of the Commonwealth of Massachusetts. The Trust was established to maintain and accumulate funds for the payment of benefits related to the Department's other post-employment benefit plans.

Purchased Power Advances

Under the terms of the Department's member agreement with Massachusetts Municipal Wholesale Electric Company, the Department is required to prepay various operating expenses and provide for certain working capital requirements for various projects that are operational. The Department charges items to expense when MMWEC indicates that an expense has been incurred.

Prepaid Expense and Other Assets

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. Other assets consist of a deposit maintained with the Department's insurance company.

Preliminary Survey and Investigation Charges

Preliminary survey and investigation charges represent costs related to capital asset construction and will be capitalized upon commencement of the project.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets

Additions to and replacements of capital assets are recorded at cost. The estimated cost, less accumulated depreciation of capital assets retired is charged against revenue in the year of disposition. Capital assets have estimated useful lives which range from 10 to 33 years. Repairs and minor renewals are charged to expense as incurred.

Deferred Outflow of Resources

A deferred outflow of resources represents a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that future time.

Accrued Compensated Absences

The Department recognizes sick and vacation leave costs as they are earned. Employees earn from 12 to 15 sick days per year depending on date of hire and 10 to 30 vacation days per year depending on date of hire and length of service. Earned days not taken accumulate, subject to certain limitations.

Customer Deposits

The Department requires security deposits from certain residential, commercial, and industrial customers. These deposits, including accrued interest, are held in escrow and reflected as a liability in the financial statements.

Other Post-employment Benefits

The financial statements include an expense for the actuarially determined recommended contribution and the related liability, for other post-employment benefits, in an amount equal to the difference between the actuarially determined recommended contribution and the actual amount contributed.

Other Noncurrent Liabilities

Other noncurrent liabilities consist of claims or other miscellaneous liabilities payable in greater than one year.

Net Position

The Department classifies net position into three components as follows:

Net Investment in Capital Assets – This component consists of capital assets net of accumulated depreciation, reduced by any related outstanding debt balance.

Restricted – This component consists of assets required to be segregated by bond agreement and or external parties. Such segregated assets are presented net of any related liabilities.

Unrestricted – This component consists of all assets and liabilities that do not meet the criteria for “Net Investment in Capital Assets” or “Restricted”.

When both restricted and unrestricted resources are available for use, it is the Department’s policy to use restricted resources first, then unrestricted resources as they are needed.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenues and Expenses

The Department distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from the sale of electricity. Operating revenues are based on authorized rates applied to each customer's consumption of electricity. They are recognized on the basis of cycle billings rendered monthly. Revenues are not accrued for services delivered beyond such billing cycle dates. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Depreciation

Depreciation of capital assets is computed using the straight-line method at composite rates as prescribed by the DPU. Depreciation was calculated using a composite rate of 3% in 2016 and 2015.

Retirement Plan

The Department participates in the Hampshire County Contributory Retirement System, which covers all employees.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could vary from those estimates.

Effect of New Accounting Standards on Current Period Financial Statements

GASB has approved GASB Statement No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68, Statement No. 74, Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans, Statement No. 75, Accounting and Financial Reporting for Post-employment Benefits Other Than Pensions, Statement No. 80, Blending Requirements for Certain Component Units, an amendment of GASB Statement No. 14, Statement No. 81, Irrevocable Split-Interest Agreements, and Statement No. 82, Pension Issues, an amendment of GASB Statements No. 67, No. 68, and No. 73.

When they become effective, application of these standards may restate portions of these financial statements.

Reclassifications

Certain amounts in the prior year financial statements have been reclassified to conform to the presentation on the current year financial statements. These reclassifications had no effect on the reported net position and change in net position.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

2. CASH and INVESTMENTS

The Department's cash and investments are segregated by purpose, recorded at fair value, and consist of both restricted and unrestricted assets. The cash and investment balances at December 31, 2016 consisted of the following:

| | <u>CASH</u> | <u>INVESTMENTS</u> | <u>STATEMENT BALANCE</u> |
|--------------------------|---------------------|---------------------|------------------------------|
| PROPRIETARY FUND | | | |
| Unrestricted | | | |
| Cash - operation fund | \$ 3,366,505 | \$ - | \$ 3,366,505 |
| MLDM Reserve Trust | 1,893,677 | 9,942,255 | 11,835,932 |
| Restricted | | | |
| Cash - depreciation fund | 5,724,967 | - | 5,724,967 |
| Cash - customer deposits | 346,330 | - | 346,330 |
| Purchased power advances | 402,903 | 718,348 | 1,121,251 |
| FIDUCIARY FUND | | | |
| OPEB Liability Trust | 33,841 | 632,370 | 666,211 |
| Total | <u>\$11,768,223</u> | <u>\$11,292,973</u> | <u>\$23,061,196</u> |

The investment balances at December 31, 2016 consisted of the following:

| | <u>COST</u> | <u>FAIR VALUE</u> | <u>UNREALIZED GAIN (LOSS)</u> |
|---|----------------------|----------------------|-----------------------------------|
| PROPRIETARY FUND | | | |
| U.S. Treasury Securities | \$ 1,921,978 | \$ 1,918,848 | \$ (3,130) |
| U.S. Agency Securities - Implicitly Guarantee | 4,047,166 | 4,028,218 | (18,948) |
| U.S. Agency Securities - Explicitly Guarantee | 2,977,228 | 2,969,713 | (7,515) |
| Municipal Bonds | 1,755,033 | 1,743,824 | (11,209) |
| FIDUCIARY FUND | | | |
| Mutual Funds - Bond Types | 212,652 | 207,192 | (5,460) |
| Mutual Funds - Equity Types | 378,707 | 425,178 | 46,471 |
| TOTAL | <u>\$ 11,292,764</u> | <u>\$ 11,292,973</u> | <u>\$ 209</u> |

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

2. CASH and INVESTMENTS (CONTINUED)

The cash and investment balances at December 31, 2015 consisted of the following:

| | <u>CASH</u> | <u>INVESTMENTS</u> | <u>STATEMENT BALANCE</u> |
|---------------------------------|----------------------|----------------------|------------------------------|
| PROPRIETARY FUNDS | | | |
| Unrestricted | | | |
| Cash - operation fund | \$ 3,331,598 | \$ - | \$ 3,331,598 |
| Investment - MLDM Reserve Trust | 2,129,622 | 9,653,428 | 11,783,050 |
| Restricted | | | |
| Cash - depreciation fund | 5,048,467 | - | 5,048,467 |
| Cash - customer deposits | 256,110 | - | 256,110 |
| Purchased power advances | 370,637 | 717,615 | 1,088,252 |
| FIDUCIARY FUNDS | | | |
| OPEB Liability Trust | 37,326 | 578,482 | 615,808 |
| TOTAL | <u>\$ 11,173,760</u> | <u>\$ 10,949,525</u> | <u>\$ 22,123,285</u> |

The investment balances at December 31, 2015 consisted of the following:

| | <u>COST</u> | <u>FAIR VALUE</u> | <u>UNREALIZED GAIN (LOSS)</u> |
|--|----------------------|----------------------|-----------------------------------|
| PROPRIETARY FUND | | | |
| U.S. Treasury Securities | \$ 5,520,372 | \$ 5,519,476 | \$ (896) |
| U.S. Agency Securities - Implicitly Guaranteed | 408,203 | 410,970 | 2,767 |
| U.S. Agency Securities - Explicitly Guaranteed | 3,608,390 | 3,604,633 | (3,757) |
| Municipal Bonds | 835,262 | 835,963 | 701 |
| Mutual Funds - Bond Types | 203,392 | 197,733 | (5,659) |
| Mutual Funds - Equity Types | 375,614 | 380,750 | 5,136 |
| TOTAL | <u>\$ 10,951,233</u> | <u>\$ 10,949,525</u> | <u>\$ (1,708)</u> |

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

2. CASH and INVESTMENTS (CONTINUED)

The Department's return on its invested assets consisted of the components reported in the statements of revenues, expenses, and changes in net position as follows:

| | 2016 | 2015 |
|---------------------------------------|-------------------|-------------------|
| INTEREST AND INVESTMENT INCOME | | |
| Interest | \$ 140,700 | \$ 155,020 |
| Unrealized Gain (Loss) | 1,917 | (36,386) |
| TOTAL | \$ 142,617 | \$ 118,634 |

Fair Value

The Department categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

Debt and equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt securities classified in Level 2 of the fair value hierarchy are valued using interest rate curves and credit spreads applied to the terms of the underlying instruments and consider the credit rating of the counterparty.

The Department's recurring fair value measurements as of December 31, 2016 are as follows:

| | Level 1 | Level 2 | Level 3 | Total |
|---|------------------|----------------------|-------------|----------------------|
| PROPRIETARY FUND | | | | |
| U.S. Treasury Securities | \$ - | \$ 1,918,848 | \$ - | \$ 1,918,848 |
| U.S. Agency Securities - Implicitly Guaranteed | - | 4,028,218 | - | 4,028,218 |
| U.S. Agency Securities - Explicitly Guaranteed | - | 2,969,713 | - | 2,969,713 |
| Municipal Bonds | - | 1,743,824 | - | 1,743,824 |
| FIDUCIARY FUND | | | | |
| Mutual Funds - Bond Types | 207,192 | - | - | 207,192 |
| Mutual Funds - Equity Types | 425,178 | - | - | 425,178 |
| Total | \$632,370 | \$ 10,660,603 | \$ - | \$ 11,292,973 |

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

2. CASH and INVESTMENTS (CONTINUED)

The Department's recurring fair value measurements as of December 31, 2015 are as follows:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|---|-------------------|----------------------|----------------|----------------------|
| PROPRIETARY FUND | | | | |
| U.S. Treasury Securities | \$ - | \$ 5,519,476 | \$ - | \$ 5,519,476 |
| U.S. Agency Securities - Implicitly Guaranteed | - | 410,970 | - | 410,970 |
| U.S. Agency Securities - Explicitly Guaranteed | - | 3,604,633 | - | 3,604,633 |
| Municipal Bonds | - | 835,963 | - | 835,963 |
| FIDUCIARY FUND | | | | |
| Mutual Funds - Bond Types | 197,733 | - | - | 197,733 |
| Mutual Funds - Equity Types | 380,750 | - | - | 380,750 |
| Total | <u>\$ 578,483</u> | <u>\$ 10,371,042</u> | <u>\$ -</u> | <u>\$ 10,949,525</u> |

Custodial Credit Risk - Cash

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, the Department's deposits may not be returned. The Department does not have a deposit policy for custodial risk. The Department, through the Town, maintains cash balances at various financial institutions located in Massachusetts. These balances are insured, subject to certain limitations, by the Federal Deposit Insurance Corporation. At certain times during the year, these cash balances may exceed the insurance limit. The amount by which the Department's cash balances may exceed the insurance limits at December 31, 2016 and 2015, has not been determined. The Department has not experienced any loss on such account and monitors the credit worthiness of the financial institutions through the Town Treasurer's Office.

Custodial Credit Risk - Investments

Custodial credit risk for investments is the risk that, in the event of a failure by a counter-party to the transaction, the Department will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Department does not have a policy for custodial credit risk, however, none of the Department's investments are uninsured and unregistered investments for which the securities are held by the counter-party, or by its trust department, but not in the Department's name.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

2. CASH and INVESTMENTS (CONTINUED)

Interest Rate Risk

Interest rate risk is the risk that the fair value of an investment will be adversely affected by changes in market interest rates. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. While the Department does not have a formal policy for interest rate risk, it does vary the duration of investments within its portfolio as a means of managing the effects of this risk.

Maturities of the Department's investments in U.S. Securities and Municipal Bonds at December 31, 2016 were as follows:

| | <u>FAIR VALUE</u> | <u>LESS THAN 1 YEAR</u> | <u>1 TO 5 YEARS</u> | <u>6 TO 10 YEARS</u> | <u>MORE THAN 10 YEARS</u> |
|--|-----------------------|-----------------------------|-------------------------|--------------------------|-------------------------------|
| U.S. Treasury Securities | \$ 1,918,848 | \$ 1,697,563 | \$ 221,285 | \$ - | \$ - |
| U.S. Agency Securities - Implicitly Guaranteed | 4,028,218 | - | 3,872,867 | 155,351 | - |
| U.S. Agency Securities - Explicitly Guaranteed | 2,969,713 | 161,654 | 2,246,547 | 401,685 | 159,827 |
| Municipal Bonds | 1,743,824 | 164,185 | 1,579,639 | - | - |
| Total | <u>\$ 10,660,603</u> | <u>\$ 2,023,402</u> | <u>\$ 7,920,338</u> | <u>\$ 557,036</u> | <u>\$ 159,827</u> |

Maturities of the Department's investments in U.S. Securities and Municipal Bonds at December 31, 2015 were as follows:

| | <u>FAIR VALUE</u> | <u>LESS THAN 1 YEAR</u> | <u>1 TO 5 YEARS</u> | <u>6 TO 10 YEARS</u> | <u>MORE THAN 10 YEARS</u> |
|--|-----------------------|-----------------------------|-------------------------|--------------------------|-------------------------------|
| U.S. Treasury Securities | \$ 5,519,476 | \$ 5,279,799 | \$ 239,677 | \$ - | \$ - |
| U.S. Agency Securities - Implicitly Guaranteed | 410,970 | - | 243,577 | 167,393 | - |
| U.S. Agency Securities - Explicitly Guaranteed | 3,604,633 | - | 2,272,093 | 167,297 | 1,165,243 |
| Municipal Bonds | 835,963 | 761,693 | 74,270 | - | - |
| Total | <u>\$ 10,371,042</u> | <u>\$ 6,041,492</u> | <u>\$ 2,829,617</u> | <u>\$ 334,690</u> | <u>\$ 1,165,243</u> |

Investments Highly Sensitive to Market Changes

The Department held investments in U.S. Agency Securities with market values of \$159,827 and \$1,165,243 at December 31, 2016 and 2015, respectively, bearing maturities date in 2028.

Credit Risk

Credit risk is the risk that the issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assigning of a rating by a nationally recognized statistical rating organization. The Department's investment policies require the investments within its portfolio to be investment grade.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

2. CASH and INVESTMENTS (CONTINUED)

The Department's investments in U.S. Securities and Municipal Bonds at December 31, 2016 and 2015 were rated as follows:

| | 2016 | | | 2015 | | |
|---|---------------|-------------------|---------------|---------------|-------------------|---------------|
| | FAIR VALUE | MOODY's RATING | S&P RATING | FAIR VALUE | MOODY's RATING | S&P RATING |
| U.S. Treasury Securities | \$ 1,918,848 | Aaa | AA+ | \$ 5,519,476 | Aaa | AA+ |
| U.S. Agency Securities - Implicitly Guaranteed | 4,028,218 | Aaa | AA+ | 410,970 | Aaa | AA+ |
| U.S. Agency Securities - Explicitly Guaranteed | 2,969,713 | Aaa | AA+ | 3,604,633 | | |
| Municipal Bonds | 1,743,824 | Aa3 | AA- | 835,963 | Aa3 | AA- |
| Total | \$ 10,660,603 | | | \$ 10,371,042 | | |

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the Department's investment in a single issuer. The Department's investment policies limit the magnitude of investment with any one single issuer (with the exception of the United States Government and its Agencies) to 5% of the portfolio value. The Department diversifies the investments within its portfolio as a means of managing the effects of this risk.

Investments in any one issuer that represent greater than 5% of total investments at December 31, 2016 include the U.S Treasury (17%), Federal Home Loan Bank (34%), Federal National Mortgage Association (12%), and Federal Home Loan Mortgage Corporation (14%). Investments in any one issuer that represent greater than 5% of total investments at December 31, 2015 include the U.S Treasury (50%), Federal National Mortgage Association (20%), and Federal Home Loan Mortgage Corporation (13%).

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

3. CAPITAL ASSETS

Capital asset activity as of and for the year ended December 31, 2016 was as follows:

| | BEGINNING BALANCE | INCREASES | DECREASES | ENDING BALANCES |
|---|------------------------------|---------------------|---------------------|----------------------------|
| CAPITAL ASSETS BEING DEPRECIATED | | | | |
| Distribution plant | \$ 29,331,508 | \$ 436,043 | \$ (189,542) | \$ 29,578,009 |
| General plant | 5,425,563 | 157,602 | (98,147) | 5,485,018 |
| Totals | 34,757,071 | 593,645 | (287,689) | 35,063,027 |
| Less: Accumulated depreciation | (29,941,083) | (1,042,712) | 287,689 | (30,696,106) |
| Total Capital Assets Being Depreciated - Net | 4,815,988 | (449,067) | - | 4,366,921 |
| CAPITAL ASSETS NOT BEING DEPRECIATED | | | | |
| Land | 344,448 | - | - | 344,448 |
| Construction in progress | 630,573 | - | (575,853) | 54,720 |
| Total Capital Assets Not Being Depreciated | 975,021 | - | (575,853) | 399,168 |
| CAPITAL ASSETS - NET | \$ 5,791,009 | \$ (449,067) | \$ (575,853) | \$ 4,766,089 |

Capital asset activity as of and for the year ended December 31, 2015 was as follows:

| | BEGINNING BALANCE | INCREASES | DECREASES | ENDING BALANCES |
|---|------------------------------|--------------------|---------------------|----------------------------|
| CAPITAL ASSETS BEING DEPRECIATED | | | | |
| Distribution plant | \$ 30,394,420 | \$ 430,038 | \$ (1,492,950) | \$ 29,331,508 |
| General plant | 5,332,512 | 93,051 | - | 5,425,563 |
| Totals | 35,726,932 | 523,089 | (1,492,950) | 34,757,071 |
| Less: accumulated depreciation | (30,228,770) | (1,071,808) | 1,359,495 | (29,941,083) |
| Total Capital Assets Being Depreciated - Net | 5,498,162 | (548,719) | (133,455) | 4,815,988 |
| CAPITAL ASSETS NOT BEING DEPRECIATED | | | | |
| Land | 333,358 | 11,090 | - | 344,448 |
| Construction in progress | 132,577 | 497,996 | - | 630,573 |
| Total Capital Assets Not Being Depreciated | 465,935 | 509,086 | - | 975,021 |
| CAPITAL ASSETS - NET | \$ 5,964,097 | \$ (39,633) | \$ (133,455) | \$ 5,791,009 |

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

4. RETIREMENT PLAN

The Department implemented the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* and GASB No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*, effective January 1, 2015. The cumulative effect of the change in net position due to the change in accounting standards is shown as a change in the beginning net position for 2015.

Plan Description

All Department employees are members of the Hampshire County Contributory Retirement System (the "System"), a cost sharing, multiple employer, defined benefit public employee retirement system (PERS). Eligible employees must participate in the System. The retirement plan provides pension benefits, deferred allowances, and death and disability benefits. Chapter 32 of the Massachusetts General Laws establishes the authority of the System, contribution percentages and benefits paid. The System Retirement Board does not have the authority to amend benefit provisions. Additional information is disclosed in the System's annual financial reports publically available from the System located at 99 Industrial Drive, Northampton, Massachusetts 01060-2326.

Benefits Provided

The System provides for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, level of compensation and group classification. Members become vested after 10 years of creditable service. A retirement allowance may be received upon reaching age 65 or upon attaining 20 years of service. The plan also provides for early retirement at age 55 if the participant (1) has a record of 10 years of creditable service, (2) was on the Department payroll on January 1, 1978, (3) voluntarily left Department employment on or after that date, and (4) left accumulated annuity deductions in the fund. A retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of the interest they generate constitute the annuity. The difference between the total retirement allowance and the annuity is the pension. The average retirement benefit is approximately 80-85% pension and 15-20% annuity. Per Chapter 176 of the Acts of 2011, for members who retire on or after April 2, 2012, if in the 5 years of creditable service immediately preceding retirement, the difference in the annual rate of regular compensation between any 2 consecutive years exceeds 100 percent, the normal yearly amount of the retirement allowance shall be based on the average annual rate of regular compensation received by the member during the period of 5 consecutive years preceding retirement. Employees who resign from service and who are not eligible to receive a retirement allowance or are under the age of 55 are entitled to request a refund of their accumulated total deductions. In addition, depending upon the number of years of creditable service, such employees are entitled to receive zero, fifty, or one hundred percent of the regular interest which has accrued upon those deductions. However, effective July 1, 2010, members voluntarily withdrawing with less than 10 years of service get credited interest each year at a rate of 3% and do not forfeit any interest previously earned on contributions.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

4. RETIREMENT PLAN (CONTINUED)

Contributions

Participants contribute a set percentage of their gross regular compensation annually. Employee contribution percentages are specified in Chapter 32 of the Massachusetts General Laws. The employee's individual contribution percentage is determined by their date of entry into the system. In addition, all employees hired after January 1, 1979 contribute an additional 2% on all gross regular compensation over the rate of \$30,000 per year. The percentages are as follows:

| | |
|-------------------------------------|-------|
| Before January 1, 1975 | 5.00% |
| January 1, 1975 - December 31, 1983 | 7.00% |
| January 1, 1984 - June 30, 1996 | 8.00% |
| Beginning July 1, 1996 | 9.00% |

Employers are required to contribute at actuarially determined rates as accepted by the Public Employee Retirement Administration Commission (PERAC). The Department's contribution to the System for the years ended December 31, 2016 and 2015 were \$360,342 and \$276,896, respectively, which were equal to its annual required contributions.

Summary of Significant Accounting Policies

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the System and additions to/deductions from System's fiduciary net position have been determined on the same basis as they are reported by System. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at fair value.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources Related to Pensions

At December 31, 2016 and 2015, the Department reported a liability of \$3,761,021 and \$2,976,687, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of December 31, 2015 and 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of January 1, 2014. The Department's proportion of the net pension liability was based on a projection of the Department's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At December 31, 2015 and 2014, the Department's proportion was 1.8110% and 1.5959%, respectively. For the year ended December 31, 2016 and 2015, the Department recognized pension expense of \$320,340 and \$296,351, respectively.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

4. RETIREMENT PLAN (CONTINUED)

Deferred outflows of resources represent consumption of net position by the Department that is applicable to future reporting periods. Deferred outflows of resources have a positive effect on net position, similar to assets. The deferred outflows of resources balances as of December 31, 2016 and 2015 were as follows:

| | 2016 | 2015 |
|--|---------------------|-------------------|
| PENSION RELATED AMOUNTS | | |
| Net difference between projected and actual earnings on pension plan investments | \$ 460,417 | \$ 94,441 |
| Changes in pension proportion and differences between contributions and proportionate share of contributions | 608,280 | 266,183 |
| Pension contributions subsequent to the measurement date | 189,429 | 170,913 |
| TOTAL | \$ 1,258,126 | \$ 531,537 |

Amounts reported as deferred outflows of resources related to pensions will be recognized in pension expense as follows:

| | | |
|--------------|-----------|------------------|
| 2017 | \$ | 179,695 |
| 2018 | | 179,695 |
| 2019 | | 179,695 |
| 2020 | | 129,292 |
| Thereafter | | 400,320 |
| Total | \$ | 1,068,697 |

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

4. RETIREMENT PLAN (CONTINUED)

Actuarial Assumptions

The total pension liability was determined by an actuarial valuation as of January 1, 2014 using the following actuarial assumptions, applied to all periods included in the measurement:

| | |
|---|--|
| Valuation Date | January 1, 2014 |
| Actuarial Cost Method | Entry Age Normal |
| Inflation | 3.00% |
| Salary Increase | 4.50% - 7.50% |
| Investment Rate of Return | 7.8750% |
| Post-retirement Cost of Living Adjustment | 3.00% of first \$13,000 |
| Pre and Post Retirement | RP-2000 Employee Mortality Table projected generationally using scale BB |
| Disabled | RP-2000 Employee Mortality Table projected generationally using scale BB set forward two years |

The actuarial assumptions used in the January 1, 2014 valuation were based on the results of the most recent actuarial experience study, which was for the period December 31, 2013. GASB 68 requires an actuarial valuation as of the measurement date or the use of roll forward procedures to the measurement date no more than 30 months and 1 day from the current fiscal year-end. The Hampshire County Plan dated December 31, 2015 uses underlying actuarial data for the period of January 1 – December 31, 2013 for the December 31, 2016 financial statements or six months beyond the allowable valuation dates. Management does not believe the timing differences between census data used in the report and actuarial valuation have a material effect on the financial statements due to the low number of employees at the Department.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

4. RETIREMENT PLAN (CONTINUED)

The long-term expected rate of return on pension plan investments was selected from a best estimate range determined using the building lock approach. Under this method, an expected future real return range (expected returns net pension plan investment expense and inflation) is calculated separately for each class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return net of investment expenses by the target allocation percentage and adding expected inflation. The target allocation and best estimate of arithmetic real rates of return for each major class are summarized in the following table:

| <u>Asset Class</u> | <u>Target Allocation</u> | <u>Long-term Expected Real Rate of Return</u> |
|-----------------------------------|--------------------------|---|
| Cash | 1.00% | 0.73% |
| Large Cap Equities | 9.00% | 4.61% |
| Small/Mid Cap Equities | 6.00% | 4.85% |
| International Equities (Unhedged) | 11.00% | 5.10% |
| International Equities (Hedged) | 0.00% | 5.34% |
| Emerging International Equities | 6.00% | 6.31% |
| Core Bonds | 7.00% | 1.42% |
| High-Yield Bonds | 3.00% | 2.91% |
| Bank Loans | 3.00% | 3.16% |
| Global Bonds (Unhedged) | 3.00% | 0.00% |
| EDM (Local Currency) | 6.00% | 4.13% |
| Private Equity | 8.00% | 6.55% |
| Private Debt | 2.00% | 5.10% |
| Real Estate | 8.00% | 3.40% |
| Hedged Funds | 11.00% | 3.88% |
| Global Asset Allocation | 16.00% | 4.17% |
| Totals | 100.00% | |

Discount Rate

The discount rate used to measure the total pension liability was 7.875%. The projection of cash flows used to determine the discount rate assumed that the plan member contributions will be made at the current contribution rate and that employer contributions will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments to current active and inactive plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

4. RETIREMENT PLAN (CONTINUED)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the Department's proportionate share of the net pension liability as of December 31, 2016 calculated using the discount rate of 7.875%, as well as what the Department's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.875%) or 1 percentage-point higher (8.875%) than the current rate:

| | 1% Decrease 6.8750% | Current Discount Rate 7.8750% | 1% Increase 8.8750% |
|--|------------------------------------|--|------------------------------------|
| Proportionate Share Of Net Pension Liability | \$ 4,739,575 | \$ 3,761,021 | \$ 2,956,665 |

The following presents the Department's proportionate share of the net pension liability as of December 31, 2015 calculated using the discount rate of 7.875%, as well as what the Department's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.875%) or 1 percentage-point higher (8.875%) than the current rate:

| | 1% Decrease 6.8750% | Current Discount Rate 7.8750% | 1% Increase 8.8750% |
|--|------------------------------------|--|------------------------------------|
| Proportionate Share Of Net Pension Liability | \$ 3,751,170 | \$ 2,976,687 | \$ 2,340,073 |

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

5. OTHER POST-EMPLOYMENT BENEFITS

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions*, requires governments to account for other post-employment benefits (OPEB), primarily healthcare, on an accrual basis rather than on a pay-as-you-go basis. The effect is the recognition of an actuarially required contribution as an expense on the statements of revenues, expenses, and changes in net position when a future retiree earns their post-employment benefits, rather than when they use their post-employment benefit. To the extent that an entity does not fund their actuarially required contribution, a post-employment benefit liability is recognized on the statement of net position over time.

Plan Description

The Department provides post-employment health and life insurance benefits for retired employees through the Town of South Hadley's Plan. Benefits, benefit levels, employee contributions and employer contributions are governed by Chapter 32 of the Massachusetts General Laws. As of January 1, 2015, the most recent actuarial valuation date, approximately 11 retirees and 21 active employees meet the eligibility requirements. The plan does not issue a separate financial report.

Funding Policy

As of January 1, 2015, the most recent actuarial valuation date, recent and new retirees contribute 26% to 45% of stated premiums for their chosen health plan, as determined by the Town of South Hadley. Retirees also contribute 50% of premiums for a \$5,000 group term life insurance benefit. The Department contributes the remainder of the medical and life insurance plan costs on a pay-as-you-go basis.

Annual OPEB Costs and Net OPEB Obligation

The Department's annual OPEB expense is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost per year and amortize the unfunded actuarial liability over a period of thirty years.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

5. OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)

The following table shows the components of the Department's annual OPEB cost, the amount actually contributed to the plan, and the change in the Department's net OPEB obligation as of December 31, 2016 and 2015:

| | 2016 | 2015 |
|--|-------------------|-------------------|
| Annual required contribution | \$ 186,161 | \$ 177,515 |
| Interest on net OPEB obligation | 23,185 | 20,569 |
| Amortization of net OPEB obligation | (32,230) | (28,593) |
| Amortization of actuarial (gains)/losses | (68,658) | (72,295) |
| | 108,458 | 97,196 |
| Annual OPEB cost | 108,458 | 97,196 |
| Contributions made | (39,261) | (31,770) |
| | 69,197 | 65,426 |
| Change in net OPEB obligation | 69,197 | 65,426 |
| Net OPEB Obligation - Beginning | 579,640 | 514,214 |
| Net OPEB Obligation - Ending | \$ 648,837 | \$ 579,640 |

The Department's annual OPEB cost, the percentage of annual OPEB cost, and the net OPEB obligation for the years ended December 31, 2016 and 2015 were as follows:

| Period Ended | OPEB Cost | OPEB Cost Contributed | Net OPEB Obligation |
|---------------------|----------------------|----------------------------------|--------------------------------|
| December 31, 2016 | \$ 108,458 | 36.20% | \$ 648,837 |
| December 31, 2015 | 97,196 | 32.69% | 579,640 |

The Department's net OPEB obligation as of December 31, 2016 and 2015 is recorded as a component of the "noncurrent liabilities" line item in the Statements of Net Position.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

5. OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)

Funded Status and Funding Progress

The funded status of the plan at January 1, 2015, the date of the most recent actuarial valuation was as follows:

| | |
|---|-------------------|
| Actuarial accrued liability (AAL) | \$ 1,460,742 |
| Actuarial value of plan assets | <u>622,895</u> |
| Unfunded actuarial accrued liability (UAAL) | <u>\$ 837,847</u> |
| | |
| Funded Ratio (actuarial value of plan assets/AAL) | <u>42.64%</u> |
| | |
| Covered payroll (active plan members) | \$ 1,508,681 |
| | |
| UAAL as a percentage of covered payroll | <u>55.54%</u> |

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The Schedule of Funding Progress, presented as required supplementary information following the Notes to the Financial Statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions

Projection of benefits for financial reporting purposes are based on the plan as understood by the Department and the plan members and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the Department and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. In the January 1, 2015 actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4% investment rate of return and an initial annual health care cost trend rate of 6.0%. The amortization costs for the initial UAAL is a level dollar amortization, with amortization payments increasing at 3% per year for a period of 30 years. An inflation rate of 3.00% was used related to compensation increases and mortality rates were represented by the RP-2000 Morality Table projected to 2017 for males and females.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

6. COMMITMENTS AND CONTINGENCIES

Massachusetts Municipal Wholesale Electric Company

The Town of South Hadley, acting through its Light Department, is a participant in certain Projects of the Massachusetts Municipal Wholesale Electric Company (MMWEC). MMWEC is a public corporation and a political subdivision of the Commonwealth of Massachusetts, created as a means to develop a bulk power supply for its Members and other utilities. MMWEC is authorized to construct, own or purchase ownership interests in, and to issue revenue bonds to finance, electric facilities (Projects). MMWEC has acquired ownership interests in electric facilities operated by other entities and also owns and operates its own electric facilities. MMWEC sells all of the capability (Project Capability) of each of its Projects to its Members and other utilities (Project Participants) under Power Sales Agreements (PSAs). Among other things, the PSAs require each Project Participant to pay its pro rata share of MMWEC's costs related to the Project, which costs include debt service on the revenue bonds issued by MMWEC to finance the Project, plus 10% of MMWEC's debt service to be paid into a Reserve and Contingency Fund. In addition, should a Project Participant fail to make any payment when due, other Project Participants of that Project may be required to increase (step-up) their payments and correspondingly their Participant's share of that Project's Project Capability to an additional amount not to exceed 25% of their original Participant's share of that Project's Project Capability. Project Participants have covenanted to fix, revise and collect rates at least sufficient to meet their obligations under the PSAs.

MMWEC has issued separate issues of revenue bonds for each of its eight Projects, which are payable solely from, and secured solely by, the revenues derived from the Project to which the bonds relate, plus available funds pledged under MMWEC's Amended and Restated General Bond Resolution (GBR) with respect to the bonds of that Project. The MMWEC revenues derived from each Project are used solely to provide for the payment of the bonds of any bond issue relating to such Project and to pay MMWEC's cost of owning and operating such Project and are not used to provide for the payment of the bonds of any bond issue relating to any other Project.

MMWEC operates the Stony Brook Intermediate Project and the Stony Brook Peaking Project, both fossil-fueled power plants. MMWEC has a 3.7% interest in the W.F. Wyman Unit No. 4 plant, which is operated and owned by its majority owner, FPL Energy Wyman IV, LLC, a subsidiary of NextEra Energy Resources LLC, and a 4.8% ownership interest in Millstone Unit #3 nuclear unit, operated by Dominion Nuclear Connecticut, Inc. (DNCI), the majority owner and an indirect subsidiary of Dominion Resources, Inc. DNCI also owns and operates the Millstone Unit 2 nuclear unit. The operating license for the Millstone Unit 3 nuclear unit extends to November 25, 2045.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

6. COMMITMENTS AND CONTINGENCIES (CONTINUED)

A substantial portion of MMWEC's plant investment and financing program is an 11.6% ownership interest in the Seabrook Station nuclear generating unit operated by NextEra Energy Seabrook, LLC (NextEra Seabrook), the majority owner and an indirect subsidiary of NextEra Energy Resources LLC. The operating license for Seabrook Station extends to March 15, 2030. NextEra Seabrook has submitted an application to extend the Seabrook Station operating license for an additional 20 years.

Pursuant to the PSAs, the MMWEC Seabrook and Millstone Project Participants are liable for their proportionate share of the costs associated with decommissioning the plants, which costs are being funded through monthly Project billings. Also the Project Participants are liable for their proportionate share of the uninsured costs of a nuclear incident that might be imposed under the Price-Anderson Act (Act). Originally enacted in 1957, the Act has been renewed several times. In July 2005, as part of the Energy Policy Act of 2005, Congress extended the Act until the end of 2025.

The South Hadley Electric Light Department has entered into PSAs and Power Purchase Agreements (PPAs) with MMWEC. Under both the PSAs and PPAs, the Department is required to make certain payments to MMWEC payable solely from Department revenues. Under the PSAs, each Participant is unconditionally obligated to make all payments due to MMWEC, whether or not the Project(s) is completed or operating, and notwithstanding the suspension or interruption of the output of the Project(s).

MMWEC is involved in various legal actions. In the opinion of MMWEC management, the outcome of such actions will not have a material adverse effect on the financial position of the company.

As of December 31, 2016, total capital expenditures for MMWEC's Projects amounted to \$1,636,734,000, of which \$55,197,000 represents the amount associated with the Department's share of Project Capability, although such amount is not allocated to the Department. MMWEC's debt outstanding for the Projects from Power Supply Project Revenue Bonds totaled \$55,795,000, of which \$1,860,000 is associated with the Department's share of Project Capability, although such amount is not allocated to the Department. As of December 31, 2016, MMWEC's total future debt service requirement on outstanding bonds issued for the Projects is \$59,281,000, of which \$1,968,000 is anticipated to be billed to the Department in the future.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

6. COMMITMENTS AND CONTINGENCIES (CONTINUED)

The estimated aggregate amount of South Hadley Electric Light Department's required payments under the PSAs and PPAs, exclusive of the Reserve and Contingency Fund billings, to MMWEC at December 31, 2016 and estimated future years is as follows:

| | <u>ANNUAL COST</u> |
|------|---------------------|
| 2017 | \$ 1,360,000 |
| 2018 | <u>606,000</u> |
| | <u>\$ 1,966,000</u> |

In addition, under the PSAs, the Department is required to pay to MMWEC its share of the Operation and Maintenance (O&M) costs of the Projects in which it participates. The Department's total O&M costs including debt service under the PSAs were \$6,327,000 and \$7,140,000 for the years ended December 31, 2016 and 2015, respectively.

Source of Labor Supply

Fifty percent of the Department's labor force is covered under a collective bargaining agreement between the South Hadley Electric Light Department and the International Brotherhood of Electrical Workers Local Union 455. The current agreement that expires June 30, 2017 was subsequently renewed for a three year period ending June 30, 2020.

Claims and Judgements

From time to time, the Department is party to various pending claims and legal proceedings. Although the outcome of such matters cannot be forecasted with certainty, it is the opinion of management and the Department's legal counsel that the likelihood is remote that any such claim or proceeding will have a materially adverse effect on the department's financial position or results of operations.

7. RISK MANAGEMENT

The Department is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors and omissions, and natural disasters, for which the Department carries commercial insurance. There were no significant reductions in insurance coverage from the previous year. There were two settlements in excess of coverage in 2016 and no settlements in excess of coverage in 2015 and 2014.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2016 and 2015

8. BEGINNING NET POSITION RESTATEMENT

The Department implemented the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27 and GASB No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*, effective January 1, 2015. In addition, the Department restated the accrued compensated absences to correct for an error in the calculation. As a result of this correction, the General and administrative expenses for 2015 were restated to reduce the expense amount by \$1,704 in the Statements of Revenues, Expenses, and changes in Net Position. As a result of these changes, the January 1, 2015 net position of the Department' proprietary fund has been restated as follows:

| | |
|--|----------------------|
| As previously reported | \$ 26,260,248 |
| Net pension liability at January 1, 2015 | (2,864,233) |
| Pension related deferred outflows at January 1, 2015 | 410,616 |
| Reclassification of OPEB Trust to separate fund | (622,895) |
| Prior auditor correction of accrued compensated absences | 384,042 |
| 2016 audit correction of accrued compensated absences | 421,043 |
| As restated | <u>\$ 23,988,821</u> |

**SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
SCHEDULE OF FUNDING PROGRESS
REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)
DECEMBER 31, 2016 AND 2015**

OTHER POST-EMPLOYMENT BENEFITS

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) Entry Age | Unfunded AAL (UAAL) | Funded Ratio | Covered Payroll | UAAL as a Percentage of Covered Payroll |
|---|--|--|------------------------------------|-------------------------|----------------------------|--|
| 01/01/16 | \$ 647,811 | \$ 1,530,524 | \$ 882,713 | 42.33% | \$ 1,553,941 | 56.80% |
| 01/01/15 | \$ 622,895 | \$ 1,460,742 | \$ 837,847 | 42.64% | \$ 1,508,681 | 55.54% |
| 01/01/14 | \$ 587,558 | \$ 1,691,268 | \$ 1,103,710 | 34.74% | \$ 1,064,922 | 103.64% |

See Independent Auditors' Report.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)
DECEMBER 31, 2016 AND 2015

| | <u>2016</u> | <u>2015</u> |
|--|--------------|--------------|
| HAMPSHIRE COUNTY RETIREMENT SYSTEM | | |
| Proportion of net pension liability for the most recent measurement date | 1.8110% | 1.5959% |
| Proportionate share of net pension liability for the most recent measurement date | \$ 3,761,021 | \$ 2,976,687 |
| Covered-employee payroll for the most recent measurement date | \$ 1,465,393 | \$ 1,274,741 |
| Proportionate share of net pension liability (asset) as a percentage of covered-employee payroll | 257% | 234% |
| Plan fiduciary net position as a percentage of the total pension liability | 55.29% | 58.07% |

Schedules are intended to show information for ten years. Additional years will be displayed as they become available.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
SCHEDULE OF CONTRIBUTIONS
REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)
DECEMBER 31, 2016 AND 2015

| | 2016 | 2015 |
|---|--------------|--------------|
| HAMPSHIRE COUNTY RETIREMENT SYSTEM | | |
| Contractually required contribution for the current fiscal year | \$ 360,342 | \$ 276,896 |
| Contribution in relation to the contractually required contribution | 360,342 | 276,896 |
| Contribution deficiency (excess) | \$ - | \$ - |
| Covered-employee payroll for the current fiscal year | \$ 1,465,393 | \$ 1,274,741 |
| Contributions as a percentage of covered-employee payroll | 24.59% | 21.72% |

Schedules are intended to show information for ten years. Additional years will be displayed as they become available.

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
SCHEDULE OF OPERATING EXPENSES
OTHER INFORMATION (Unaudited)
YEARS ENDED DECEMBER 31, 2016 AND 2015

| | <u>2016</u> | <u>Restated 2015</u> |
|---|-----------------------------|-----------------------------|
| OPERATING EXPENSES | | |
| Cost of Power Sold | | |
| Purchased power | \$ 8,179,358 | \$ 9,281,559 |
| Transmission expense | 2,220,261 | 2,072,986 |
| Supplies and expense | 223,542 | 168,002 |
| Total Cost of Power Sold | <u>10,623,161</u> | <u>11,522,547</u> |
| Distribution Expense | | |
| Salaries and wages | 646,915 | 640,912 |
| Supplies and expense | 341,262 | 305,549 |
| Total Distribution Expense | <u>988,177</u> | <u>946,461</u> |
| Customer Accounts Expense | | |
| Salaries and wages | 203,099 | 206,192 |
| Supplies and expense | 107,679 | 156,134 |
| Total Customer Accounts Expense | <u>310,778</u> | <u>362,326</u> |
| General and Administrative Expense | | |
| Salaries and wages | 351,226 | 540,897 |
| Supplies and expense | 280,194 | 194,125 |
| Pension and benefits | 1,253,517 | 378,403 |
| Insurance | 102,400 | 95,056 |
| Legal and consulting | 137,136 | 119,370 |
| General | 22,106 | 16,945 |
| Total General and Administrative Expense | <u>2,146,579</u> | <u>1,344,796</u> |
| Depreciation Expense | | |
| Distribution and general plant | <u>1,042,712</u> | <u>1,071,808</u> |
| TOTAL OPERATING EXPENSES | <u><u>\$ 15,111,407</u></u> | <u><u>\$ 15,247,938</u></u> |

See Independent Auditors' Report.